BEFORE THE
UNITED STATES SENATE
COMMITTEE ON COMMERCE
SUBCOMMITTEE ON COMMUNICATIONS

TESTIMONY OF
STEPHEN C. GRAY
PRESIDENT AND CHIEF OPERATING OFFICER
PRESIDENT AND CHIEF EXECUTIVE OFFICER – LOCAL SERVICES
MCLEODUSA INCORPORATED

CONCERNING THE ISSUE OF
BROADBAND DEPLOYMENT AND
PROPOSED RBOC DATA RELIEF LEGISLATION

McLeodUSA Incorporated
McLeodUSA Technology Park
6400 C Street SW
P.O. Box 3177
Cedar Rapids, Iowa 52406-3177

March 28, 2000

Summary of Testimony

McLeodUSA, headquartered in Cedar Rapids, Iowa, is a leading facilities-based Integrated Communications Provider serving both residential and business customers. We currently operate in 12 Midwest and Rocky Mountain states; nine additional states have been targeted for expansion. We have focused on serving customers in smaller markets (Tier 2, 3, 4), rather than in major metropolitan areas. The core business of McLeodUSA is to provide "one-stop," integrated communications services including local, long distance, high-speed Internet access, voice mail and paging all from a single company on a single bill, tailored to the customer's needs. McLeodUSA, with 8,100 employees, has currently deployed over 10,000 miles of fiber. The Company derives its revenues from the sale of telecommunications services and the publication of telephone directories. McLeodUSA Publishing will print and distribute more than 25 million directories in 23 states, reaching 43 million people, over the next 12 months.

McLeodUSA strongly encourages Congress to resist any RBOC proposal for broadband data relief. The 1996 Telecommunications Act is working to bring competition to telecommunications consumers in all areas of the country. While that competition is not progressing as rapidly as many would hope or were led to believe in 1996, the delays have resulted not from inadequate legislation, but from a failure of the incumbent RBOCs to fulfill their duties under that legislation. Attempting to impose an artificial distinction between data and voice services will only serve to delay the deployment of advanced services and the development of competition in general. This result will disadvantage consumers, and delay the goal of providing faster, better, less expensive telecommunications services to all Americans.

Finally, if high speed data services and facilities are deregulated, confusion about ultimate goals will not be limited to customers. McLeodUSA is acutely aware of the need to maintain investor confidence in the national goal of bringing competition to the telecommunications marketplace. That confidence has been bolstered by the clear commitment to the 1996 Telecommunications Act, and the efforts of the FCC, to reach that national goal. Legislation which would carve out data services from the pro-competitive goals of the Act would be seen in financial markets as a retreat from that national commitment. As a result, the ability of new entrants to raise the capital needed to bring true, facilities-based competition to all telecommunications markets could be placed in jeopardy. Thus, the drive toward competition could be slowed even though that is not what was intended by supporters of such "data deregulation" legislation.

On behalf of McLeodUSA, I would like to thank the Subcommittee for the opportunity to talk with you today. I would like to accomplish three goals today: first, provide a high level overview of McLeodUSA; second, summarize our concerns with providing broadband data "relief" to the RBOCs; and third, emphasize Wall Street's predictable reaction to providing "data relief" to the RBOCs.

I. McLeodUSA Overview

Clark McLeod and I formed McLeodUSA, headquartered in Cedar Rapids, Iowa, in 1992. This is not our first foray into telecommunications. In the early 1980s, Clark formed Teleconnect and built it into the fourth largest long distance company in the United States. In 1990, MCI purchased the company, then named TelecomUSA. McLeodUSA is a member of the major trade associations representing the competitive telecommunications industry, the Competitive Telecommunications Association (CompTel), and the Association for Local Telecommunications Services (ALTS).

In 1992, desiring to bring competition to the local telephone industry, we formed what today is called McLeodUSA Incorporated. Our primary focus as a company has been to serve small business and residential customers in the Tier 2, 3, and 4 markets in our target states. As a result (as of January 1, 2000), we provided competitive local exchange services to over 280,000 telecommunications customers, in the 12 Midwest and Rocky Mountain states. (We have targeted an additional 9 states for expansion this year). Nearly 30 percent of the 679,000 total access lines served by McLeodUSA are residential lines. Our average business customer subscribes to 5.5 lines.

McLeodUSA's corporate team, with over 250 years of experience, is recognized as one of the strongest management groups in the telecom industry. Strong because of our breadth, and strong because of our depth.

McLeodUSA has already become the leading facilities-based Integrated Communications Provider (ICP) in our market area, providing local, long distance and high-speed Internet services.

McLeodUSA derives its revenues primarily from the sale of telecommunications services and the publication of telephone directories. McLeodUSA has developed one of the largest competitive white and yellow page directory companies in the United States. In fact, McLeodUSA Publishing will print and distribute more than 25 million directories in 23 states, reaching 43 million people, over the next 12 months.

The opportunity for our employees is incredible: one third of our stock ownership resides with employees. This is an important linkage for our investors, and gives our employees a major stake in our success.

McLeodUSA's three-part phased execution is success based. First, building local line market share by resale and by leasing Bell facilities...concurrently expanding our brand presence.

Second, building the platform, with inter-city fiber connecting regional gateways.

And third, our current phase, migrating customer traffic on-switch/on-net, which involves constructing intra-city fiber which connects our customers with our regional gateways.

This execution allows us 100% access to build customer share, while capital is efficiently and effectively deployed.

In our first phase of building customer share, we have leased RBOC central offices, which allows us to sell to 100% of the customers in our 592 cities. In addition to pervasive coverage, this service is relatively easy for the Bells to provision and is generally a transparent switch over. Once the switch has occurred, we control many of the features for the customers through on-line provisioning terminals.

Our data strategy, with our recent acquisition of Splitrock Services, Inc. and the addition of industry veteran Roy Wilkens to our management team, will add new revenue opportunity from our collocations and XDSL technology. The Splitrock network includes 350 ATM (asynchronous transfer made) switches providing dial-up and dedicated data services to other competitive local exchange carrier (CLECs), internet service providers (ISPs) and large multi-state business customers. Splitrock also has a 20-year irrevocable right of use (IRU) for up to 16 fibers in a 16,000-mile network. This broadband network is capable of carrying integrated voice, data and video signals to 90 percent of the nation’s population in 800 cities across all 50 states.

Concurrent with building customer share, we have executed the 2nd phase of our strategy and deployed the most advanced platform in our region. Over 10,000 miles, both intra-city and inter-city, high-density fiber, SONET ring topology, with incredible capacity, is capable of supporting all our voice, data and video applications.

For the last 5 years, McLeodUSA has been focused primarily on the voice market; however, the data opportunity is explosive. Data revenues will surpass voice revenues in 2009. And the bandwidth required to capture data will require companies to own or control high capacity networks. McLeodUSA is positioned for these opportunities in several key areas.

First, the market position. Our customers conveniently have only one number to call for customer service, and one bill provides the best value proposition -- one company, simple and complete.

Second, our customer service is World Class. Our goal is to have a real person

answering calls within 20 seconds, 24 hours a day, 7 days a week, with one call resolutions. Great people providing great service. McLeodUSA has proof. Since 1994, we have averaged 0.5% business customer churn, the lowest in the industry.

Finally, from a platform position, we can pick the best solution for the customer and the company. Our collocations connect to local access rings, which connect to 500 mile backbone rings, which then attach to high capacity regional gateways. This design is a low cost way to serve 1st, 2nd and 3rd tier markets with one regional center, robust capacity, and functionality. It also allows us to use both our network and the Bell network to optimize the economics.

Our results through end of year 1999 have been incredible.

Directories:	1998: 14 million	1999: 21 million
Local Lines:	1998: 400,000	1999: 679,000
Network:	1998: over 7,000 miles	1999: over 9,000 miles
Revenue:	1998: $600 million	1999: $909 million

II. Concerns about providing “data relief" to the RBOCs

Based on the progress that McLeodUSA has made in bringing competition to its markets, it is tempting to conclude that all must be going well in the world of emerging telecommunications competition. This optimistic conclusion, however, ignores the reality faced by McLeodUSA every day: that the incumbent RBOCs upon whom we depend for inputs are doing everything in their power to limit our ability to serve our customers. Those companies, at every turn, make use of each opportunity to introduce delay, uncertainty, and unnecessary expense into our business relationship.

This situation reveals an important fact about the relationship between emerging competitors like McLeodUSA and established incumbent RBOCs: the grossly unequal commercial power between those entities. Typically, when two companies negotiate a commercial agreement, both parties have something to gain and something to lose; and that situation leads both parties to seek a result where there is mutual benefit. In such a case, because either party can seek a better bargain elsewhere, both parties seek a compromise solution that maximizes their mutual gains. In contrast, our relationships with RBOCs show clearly that those companies believe they have nothing to gain by dealing with McLeodUSA. As a result, we typically find that compromise is not possible, and we are told that, if we disagree with an RBOC position, we will need to seek regulatory relief.

An example of this type of conduct is instructive. We have had a dispute with an RBOC about the charges that we pay when we order unbundled loops; not the recurring "monthly" charge (which we also believe is generally too high), but simply the one-time charge to have the loop supplied at all. We are sometimes charged thousands of dollars when the RBOC supplies these loops, even though there is no charge at all when the same service is provided to the same location by the RBOC for its own end-user customer. We know that this is the case

because, when these charges have made it financially impossible for use to serve the customer ourselves, that customer has ordered the same service from the RBOC and not been charged for such "special construction."

Under the forward-looking TELRIC pricing standards used to determine rates for unbundled loops, we believe that loop costs should already include the ability to "unbundle" loops. Even if this were not the case, however, there is certainly no reason for competitive carriers to be charged by the RBOC when the RBOC would not charge its own end-users. We believe this situation is a clear example of discrimination against companies like McLeodUSA. At least two state commissions -- the Michigan Public Service Commission and the Illinois Commerce Commission -- have agreed, and has refused to allow such "special construction" charges for unbundled loops.

Of course, the RBOC is appealling those decisions to court; and when we have attempted to use the reasoning of those decisions in the RBOC's other states to convince them to change their position on this issue, the response we received was a flat "no," with the notation that we were free to litigate before the other state commissions if we so desired.

This result plays into the RBOC's long-term strategy in two ways. First, by requiring new competitors to expend their resources litigating issues multiple times before regulatory agencies and in subsequent court appeals, they are effectively diverting the competitor's resources away from the goal of providing competitive services to customers. Second, by simultaneously attempting to convince state legislatures and the Congress that regulatory oversight must be reduced, they are trying to close the only channel available to us to obtain fair treatment. And that brings us squarely to the subject before the Subcommittee today.

It is clear to me in my job as President of McLeodUSA that the RBOCs with which we deal are not committed to allowing competitive markets to develop in their historical monopoly territories. Instead, it appears that these RBOCs are committed to finding a way to enter markets which are "off limits" under the Telecom Act while preserving their local exchange monopolies essentially intact. Deregulation of data services is an integral part of that strategy.

News reports, industry analysts, and assorted pundits have all noted the "convergence" of voice and data technology in recent years. My company firmly believes in such convergence. Given this phenomenon, it is not at all clear why policy-makers should spend the effort required in an attempt to develop separate legal frameworks for voice and data. The Telecommunications Act itself defines "telecommunications" to include any "information of the user's choosing." This definition on its face includes voice, data, video, and all other sources of "information." If the data services were not to be included within the procompetitive framework of the Act, it would have been a simple matter to specify that telecommunications included only "voice" services; yet the Congress did not do that when the Act was passed in 1996. Existing law makes no artificial distinction between voice and data services; both are considered to be "telecommunications." This is a wise course, and it should be maintained.

In fact, attempting to develop separate frameworks is bound to result in an artificial situation which is more complicated, less efficient, and ultimately does not serve the needs of our customers. In the long run, there will be no reasonable distinction that can be made between voice and data as it is carried over telecommunications networks. Even now, much of the voice traffic carried on existing telecommunications networks is carried in digital form. Since digital information is nothing more than a string of binary digits (carried either electronically or in optical form), there is no way to distinguish digital voice signals from other digital signals once the conversion to a digital signal is made. Thus, a legal distinction based on differences between "voice" and "data" is bound to fail.

The only way this traffic can be practically separated is before digital conversion. Yet, we will increasingly see digital conversions taking place at the home, or within the telephone network prior to switching. As a result, by the time the digital signal is ready to be switched, it will already be in digital form, ready to be placed onto a packet-switched network. There will be no distinction to be made between voice and data in such a world.

The structure of the Telecommunications Act is not based upon specific technologies or traffic patterns. Rather, that structure is based upon an immutable fact: for the foreseeable future, in most circumstances, new competitors will have no alternative but to use the existing loop distribution plant (the "copper wires") of the incumbent RBOCs. The Telecommunications Act makes those copper wires available for lease by competitors not because they are necessary to provide voice service, but because they are necessary to provide any service to the household served by them. Those wires constitute a bottleneck which the RBOCs will use to stifle the drive toward competitive local markets unless prevented by regulators and legislators from doing so. A drive to "deregulate" those bottleneck facilities simply because they are used for data transmission is exactly the wrong response if we want competitive markets to fully develop.

RBOC control of that bottleneck will be just as damaging to the development of competition for data services as it has been for voice service, if control of the bottleneck facility is not held in check by regulatory oversight. Even if one attempts to distinguish between voice and data service, it is clear that those wires are just as necessary for data as they are for voice. Increasingly, consumers will use those copper wires to transmit both voice and data, with little distinction between the two. Constructing differing regulatory regimes for each will only confuse customers and hinder our pursuit of the ultimate goal of competition in all telecommunications markets.

III. Wall Street's predictable reaction to RBOC “data relief" proposal

Finally, if high speed data services and facilities are deregulated, confusion about ultimate goals will not be limited to customers. McLeodUSA is acutely aware of the need to maintain investor confidence in the national goal of bringing competition to the telecommunications marketplace. That confidence has been bolstered by the clear commitment

to the 1996 Telecommunications Act, and the efforts of the FCC, to reach that national goal. Legislation which would carve out data services from the procompetitive goals of the Act would be seen in financial markets as a retreat from that national commitment. As a result, the ability of new entrants to raise the capital needed to bring true, facilities-based competition to all telecommunications markets could be placed in jeopardy. Thus, the drive toward competition could be slowed even though that is not what was intended by supporters of such "data deregulation."

Conclusion

The 1996 Telecommunications Act is working to bring competition to telecommunications consumers in all areas of the country. While that competition is not progressing as rapidly as many would hope or were led to believe, the delays have resulted not from inadequate legislation, but from a failure of the incumbent RBOCs to fulfill their duties under that legislation. Attempting to impose an artificial distinction between data and voice services will only serve to delay the deployment of advanced services and the development of competition in general. This result will disadvantage consumers, and delay the goal of providing faster, better, less expensive telecommunications services to all Americans.

Again, I thank the Subcommittee for the opportunity to appear before you today, and would welcome the opportunity to answer any questions that any of the Members might have.